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In the Supreme Court of the United States

OCTOBER TERM, 1979

CHROME PLATE, INC., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether petitioner's subsidiary's basis in the assets of several corporations (the stock of which petitioner acquired and transferred to its subsidiary which thereafter liquidated them) is equal to the basis of such assets in the hands of the liquidated corporations in accordance with Section 334(b)(1) of the Internal Revenue Code of 1954, as the decision below held, or is equal to petitioner's cost of the underlying corporate stock, as petitioner contends.

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OPINION BELOW

The judgment of the bankruptcy court (Pet. App. C-1 to C-9) is unreported. The opinion of the district court (Pet. App. B-1 to B-13) is reported at 442 F. Supp. 1023. The opinion of the court of appeals (Pet. App. A-1 to A-17) is reported at 614 F. 2d 990.

JURISDICTION

The judgment of the court of appeals was issued on April 2, 1980 (Pet. App. A-1). The petition for a writ of certiorari was filed on June 26, 1980. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Petitioner, Chrome Plate, Inc., was engaged in the business of chrome plating aircraft cylinders. It determined to acquire six corporations owned primarily by Clarence Page (Page corporations) which were engaged in related businesses. Accordingly, petitioner created a wholly-owned subsidiary, Chrome Plate Industries, Inc., which, in turn, formed its own subsidiary, Page Industries of Oklahoma, Inc. (PIOI). On December 28, 1972, Chrome Plate Industries purchased all of the stock of the Page corporations for $850,000 in cash and notes. Immediately following this acquisition, Chrome Plate Industries transferred the Page corporations' stock to PIOI in exchange for 849,000 shares of PIOI's common stock, in a transaction that was tax-free under Section 351 of the Internal Revenue Code of 1954. On December 29, 1972, PIOI liquidated the six Page corporations and succeeded to their assets (Pet. App. A-1 to A-2).

Upon liquidating the six Page corporations, PIOI stepped up the basis of their assets to $849,000, the price paid by its parent, Chrome Plate Industries, for the Page corporations' stock. On audit, the Commissioner of

Internal Revenue determined that PIOI was required to take a carryover basis under Section 334(b)(1) equal to the Page corporations' basis in the assets. In the Commissioner's view, PIOI's overstated basis gave rise to excessive depreciation deductions, resulting in an understatement of petitioner's taxable income in 1973, and an overstatement of its net operating loss carryback to 1970 (Pet. App. C-5).

Petitioner, Chrome Plate Industries, and PIOI all filed a consolidated return. In a subsequently filed bankruptcy proceeding commenced by petitioner in the United States District Court for the Western District of Texas, the Internal Revenue Service filed a claim in bankruptcy asserting deficiencies in income taxes of $52,967.34 for 1970 (Pet. App. C-3). The bankruptcy court held for petitioner on the ground that it entered into the transaction with the purpose of acquiring the assets of the Page corporations. As the bankruptcy court reasoned, under the "*Kimbell-Diamond* doctrine" (see *Kimbell-Diamond Milling Co.* v. *Commissioner*, 14 T.C. 74 (1950), aff'd per curiam, 187 F. 2d 718 (5th Cir.), cert. denied, 342 U.S. 827 (1951)), petitioner's purchase of the Page corporations' stock should be treated as a direct purchase of those assets, so that the cost of the stock should be equal to its basis for the assets (Pet. App. C-6).

The district court reversed.[1] It held (Pet. App. B-8 to B-9) that the exception to the carryover basis rule provided by the *Kimbell-Diamond* doctrine is available under the 1954 Code only to the extent a liquidation meets the requirements of Section 334(b)(2). Because PIOI's liquidation of the Page corporations failed to qualify

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[1] The district court also held it had no jurisdiction to consider a refund claim filed by petitioner for 1973 (Pet. App. B-2). Petitioner did not appeal from that ruling.

under Section 334(b)(2), PIOI was not entitled to a stepped-up basis in the Page corporations' assets it received on the liquidation (Pet. App. B-11).

The court of appeals affirmed. It first noted that the principles of *Kimbell-Diamond* were "effectuated" by the enactment of Section 334(b)(2) (Pet. App. A-11). As the court of appeals viewed the matter, Congress provided a specific statutory framework within which corporations could achieve the results previously available only under the *Kimbell-Diamond* doctrine. The court of appeals therefore held "positively and conclusively that the *Kimbell-Diamond* doctrine is abolished in regard to corporate taxpayers, and the only opportunity to receive a cost basis in complete liquidation of a subsidiary is by fully complying with §334(b)(2)" (Pet. App. A-17). Thus, where, as here, a taxpayer fails to qualify under the specific provisions of Section 334(b)(2), the general provisions of Section 334(b)(1) are applicable and the acquiring corporation must take a carryover basis in the liquidated assets received on liquidation (Pet. App. A-17).

ARGUMENT

1. The court of appeals correctly held that PIOI's basis in the Page corporations' assets received on the liquidation must equal those corporations' basis in those assets, in accordance with Section 334(b)(1) of the Code.

The liquidation by a parent corporation of its controlled subsidiary is a tax-free event under Section 332. But ultimate taxability of any gain arising from the parent's disposition of the assets received on the liquidation is preserved by virtue of the basis rules of Section 334(b). Section 334(b)(1) provides generally that if a corporation receives property in such a liquidation, the basis of the property in the hands of the corporation shall be the same as it would be in the hands of the liquidating

transferor, *i.e.*, a carryover basis. Section 334(b)(2) provides the sole exception to this rule. That subsection provides that in certain circumstances, where a corporation has purchased a controlling interest in the stock of the distributing corporation within a 12-month period and liquidates the corporation, pursuant to a plan of liquidation adopted not more than two years after the purchase, then the acquiring corporation's basis in the assets shall be the same as its basis in the stock. The statute requires that the stock must have been acquired by the distributee by "purchase" as defined in Section 334(b)(3). Section 334(b)(2)(B). Finally, Section 334(b)(2)(B) clearly provides that the purchase requirement is not met where the distributee acquires the stock in a tax-free exchange under Section 351, relating to transfers of property to a corporation controlled by the transferor.

Petitioner concedes (Pet. 4, 21) that PIOI acquired the Page corporations' stock from Chrome Plate Industries in a tax-free Section 351 exchange. Accordingly, as the court of appeals held, Section 334(b)(2) is inapplicable, and the general rule of Section 334(b)(1) applies. PIOI was therefore required to take a carryover basis in the assets received on the liquidation of the Page corporations in accordance with the general rule of Section 334(b)(1).

2. Petitioner argues (Pet. 13) that the decision below conflicts with *American Potash & Chemical Corp.* v. *United States*, 399 F. 2d 194, modified on other grounds, 402 F. 2d 1000 (Ct. Cl. 1968). There, a corporation acquired the requisite controlling percentage of the stock of another corporation over a 14-month period and thereafter liquidated the acquired entity. Because Section 334(b)(2) requires acquisition of the stock over a 12-month period, the government argued that the taxpayer was required to take a carryover basis in the subsidiary's assets equal to the subsidiary's basis in those assets.

The Court of Claims disagreed. It held that even though a liquidation does not satisfy the technical requirements of Section 334(b)(2), the parent's cost basis in the subsidiary's assets will nevertheless be equal to its cost for the subsidiary's stock as long as the parent purchased the stock with a view to acquiring the subsidiary's assets. In so holding, the Court of Claims applied the rule of *Kimbell-Diamond Milling Co.* v. *Commissioner,* 14 T.C. 74 (1950), aff'd per curiam, 187 F. 2d 718 (5th Cir.), cert. denied, 342 U.S. 827 (1951). There, the Tax Court treated the purchase by one corporation of the stock of another corporation, closely followed by the liquidation of the newly acquired subsidiary, as a purchase of assets. It thereby held that the basis of the assets was equal to the cost of the stock because the stock was purchased for the purpose of acquiring the assets. The Court of Claims accordingly remanded the case "to the trial commissioner * * * to make findings of fact and a recommended conclusion of law on whether the *Kimbell-Diamond* doctrine applies to the facts of this case * * *" (399 F. 2d at 209).

While three other circuits disagree with the Court of Claims' view as to the viability of the *Kimbell-Diamond* doctrine, there is no conflict between the decision below and *American Potash*. Although it expressed the view that the *Kimbell-Diamond* doctrine might not have been completely superseded by Section 334(b)(2), the Court of Claims in *American Potash* was not faced with the question presented in the instant case, *viz.*, whether the *Kimbell-Diamond* doctrine could apply to a Section 351 exchange despite the explicit language of Section 334(b)(2)(B) to the contrary. Since it is not clear that the

Court of Claims would apply the *Kimbell-Diamond* doctrine to the facts of the instant case involving a Section 351 exchange, there is no conflict of decisions requiring resolution by this Court.

2. At all events, as the court of appeals correctly noted (Pet. App. A-12 to A-15), since the Court of Claims' decision in *American Potash*, three circuits and the Tax Court have held that the *Kimbell-Diamond* doctrine did not survive the enactment of Section 334(b)(2). These courts have correctly recognized that if the *Kimbell-Diamond* rule were still viable the detailed language of Section 334(b)(2) would be rendered superfluous.[2] Thus, the courts have held *Kimbell-Diamond* to be inapplicable in cases where the taxpayer met all of the objective requirements of Section 334(b)(2) but sought to demonstrate that its stock acquisition was not subjectively intended to lead to an acquisition of assets. See, *e.g.*, *Supreme Investment Corp.* v. *United States*, 468 F. 2d

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[2]Petitioner argues (Pet. 21-22) that the formalities of organization should be disregarded in the amendment of the definition of "purchase" in Section 334(b)(3) by the Act of November 13, 1966, Pub. L. 89-809, 80 Stat. 1539, 1576. That amendment was necessary to cure the timing problem created where a chain of subsidiaries was acquired and liquidated into the parent in the wrong order. See B. Bittker & J. Eustice, *Federal Income Taxation of Corporations and Shareholders* para. 11.44 (4th ed. 1979). As petitioner sees the matter (Pet. 22), Congress recognized that the formal distinction of the order of liquidation should make no difference as to the basis received, and that it would amend the statute again if presented with the facts of this case. That contention is, of course, mere speculation. But, more importantly, the fact that the 1966 amendment was deemed necessary shows that Congress meant Section 334(b)(2) to be interpreted according to its terms. If petitioner were correct, the 1966 statutory amendment would have been entirely unnecessary, because the general principles of *Kimbell-Diamond* could have been applied whatever the order of liquidation of the chain of subsidiaries.

370, 377 (5th Cir. 1972); *Pacific Transport Co.* v. *Commissioner*, 483 F. 2d 209 (9th Cir. 1973), cert. denied, 415 U.S. 948 (1974); *Boise Cascade Corp.* v. *United States*, 288 F. Supp. 770 (D. Idaho 1968), aff'd per curiam, 429 F. 2d 426 (9th Cir. 1970). Moreover, in *Broadview Lumber Co.* v. *United States*, 561 F. 2d 698 (7th Cir. 1977), the court likewise upheld the government's position that "the subjective intent tests of *Kimbell-Diamond* are precluded in cases falling within the ambit of Section 334(b)(2)" (*id.* at 712 n.30). There, in accord with the decision below, the court held (1) that the taxpayer had not met the requirements of Section 334(b)(2); (2) was therefore required to take a carryover basis in the acquired assets; and (3) that the taxpayer could not invoke the *Kimbell-Diamond* doctrine to achieve a contrary result because "the subjective intent tests of *Kimbell-Diamond* have been replaced in certain instances by the objective standards of section 334(b)(2) * * *" (561 F. 2d at 714). Accord: *International State Bank* v. *Commissioner*, 70 T.C. 173, 180-181 (1978).[3]

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[3]Contrary to petitioner's argument (Pet. 12), Rev. Rul. 67-274, 1967-2 Cum. Bull. 141, and Rev. Rul. 74-35, 1974-1 Cum. Bull. 85, do not support the proposition that *Kimbell-Diamond* has not been supplanted by Section 334(b)(2). Those rulings discuss the applicability of the step transactions doctrine in the contexts of a corporate reorganization and a partial liquidation. We do not claim that the step transaction doctrine and the substance-over-form doctrine have been eliminated generally. As we have noted, where Congress has specifically limited the application of these principles in a given context by enacting statutory criteria for certain tax treatment, as in Section 334(b)(2), the statutorily imposed conditions must be respected. *Broadview Lumber Co.* v. *United States, supra*; *Kansas Sand & Concrete, Inc.* v. *Commissioner*, 56 T.C. 522 (1971), aff'd, 462 F. 2d 805 (10th Cir. 1972). See also *Supreme Investment Corp.* v. *United States, supra*, 468 F. 2d at 379. Cf. *Commissioner* v. *Nat. Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134, 149 (1974), where this Court said: "while a taxpayer is free to organize his affairs as he chooses, nevertheless, once having done so, he must accept the tax

At all events, the uniform line of decisions since *American Potash* suggests that the Court of Claims might well reconsider its views on the broader question whether the *Kimbell-Diamond* doctrine survives the enactment of Section 334(b)(2).[4] Since there is no conflict on the narrow question presented involving a Section 351 exchange, and there is now a trend of decisions in accord with the court of appeals' observation here that "the *Kimbell-Diamond* doctrine is abolished in regard to corporate taxpayers" (Pet. App. A-17), there is no basis for review by this Court in the instant case.[5]

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consequences of his choice, whether contemplated or not * * * and may not enjoy the benefit of some other route he might have chosen to follow but did not."

[4]Even if the *Kimbell-Diamond* doctrine were still viable, petitioner did not comply with its requirements. Petitioner concedes (Pet. 3) that there were business reasons for maintaining the assets in a subsidiary, rather than commingling them with its own assets. Thus, this case is distinguishable from *Kimbell-Diamond* because petitioner chose to operate a separate corporation, rather than acquiring assets for use in an existing business. If petitioner, like the taxpayer, Kimbell-Diamond, wanted only assets for use in its existing business, it would have had no need to create an intervening corporate structure. Cf. *United States* v. *M.O.J. Corp.*, 274 F. 2d 713 (5th Cir. 1960).

[5]Petitioner further contends (Pet. 26, 27) that the separate corporate identities of Chrome Plate Industries and PIOI can be ignored so that the purchase of stock by Chrome Plate Industries can be treated as the purchase of stock by PIOI, simply because both corporations joined in a consolidated return. The court of appeals correctly rejected this argument (see Pet. App. A-5, A-7). Petitioner has cited no authority for this proposition, and we submit that there is none. The applicable Regulations (Treasury Regulations on Income Tax (1954 Code) Section 1.1502-31(b)(2)(i) (26 C.F.R.)), are clearly to the contrary. They provide: "The basis of property acquired in a liquidation to which section 332 applies shall be determined as if separate returns were filed." See also F. Peel, *Consolidated Tax Returns* 210-211 (2d ed. 1973).

CONCLUSION

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

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